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Bidding Battle In Texas Shifts To Weak Thrifts

By BARBARA A. REHM

The reshaping of Texas banking continued last week as two large out-of-state companies vied for one of the state's most attractive retail franchises. In the end, Banc One beat out NCNB for Dallas-based Bright Banc Savings Association.

Now the two aggressive acquirers are expected to turn their bargain-hunting further south, to the $2 billion-asset San Antonio Savings Association.

Banc One Corp., which is based in Columbus, Ohio, and NCNB Corp., based in Charlotte, N.C., are pursuing the same strategy in Texas. Each acquired a large failing commercial bank with government funds – Banc One bought MCorp last summer and NCNB bought First Republic-Bank Corp. in 1988.

ANALYSIS *Follow-up on the news*

Now each bank is scrambling to acquire broke S&Ls to fill out their franchises.

On Friday, the government's Resolution Trust Corp. sold Bright Banc's $2.7 billion in deposits to Banc One for $45 million. Banc One also acquired $1.7 billion of performing assets.

Keeping Out the Competition

Most analysts speculated that regulators rejected NCNB's bid, not because it was too low, but because NCNB already controls a large chunk of the Dallas deposit market. These analysts said NCNB certainly could have afforded the $45 million price tag and would have wanted to keep Banc One out.

"NCNB is going to bid on everything, not that it needs anything, but to keep the competition out," said Frank Anderson, a senior analyst with Stephens Inc., a brokerage company in Little Rock, Ark.

NCNB has acquired five thrifts in the state. In its largest, the Oct. 13 acquisition of University Federal Savings Association, Houston, NCNB spent $129 million to buy $3.5 billion in deposits.

Mr. Anderson predicted in an interview Monday that both Banc One and NCNB will try to continue their expansions by buying San Antonio Savings, a $2.3 billion-asset thrift seized by the government in March 1989.

"San Antonio Savings would really propel one of these banks into that market," he said. "I think Banc One and NCNB will both be strong bidders."

Another likely shopper will be banking titan Citicorp, which has looked but not yet bought a

See **BANC ONE** *page* **14**

INSIDE NEWS

INTERNATIONAL

U.S. BANKS were the most profitable in the world in 1988, according to a survey by IBCA Ltd. The top-rated American bank company was Banc One Corp. *Page 10*

CONSUMER

DISCOVER EARNED $80.2 million last year, contributing almost half the profits of Sears, Roebuck and Co.'s Dean Witter Financial Services subsidiary. *Page 6*

FINANCE

STOCK IN BANKS OF IOWA rose as the state appeared ready to set a trigger for interstate banking. The company has a merger pact with Minnesota's First Bank System. *Page 16*

REAL ESTATE

MIDWESTERN BANKS are avoiding the severe real estate problems that plague institutions elsewhere partly because of cautious lending practices, say industry analysts. *Page 8*

PEOPLE

A.W. CLAUSEN announced he will retire as chairman and CEO of BankAmerica Corp. on May 24. Richard M. Rosenberg will succeed him. *Page 2*

TECHNOLOGY

MARYLAND NATIONAL will test a software system, known as Crisp, that gauges the profitability of commercial loans. *Page 3*

OTHER NEWS

A HOUSE PANEL asked the director of the CIA to respond to a report that fraudulent agency loans contributed to 22 thrift failures. *Page 2*

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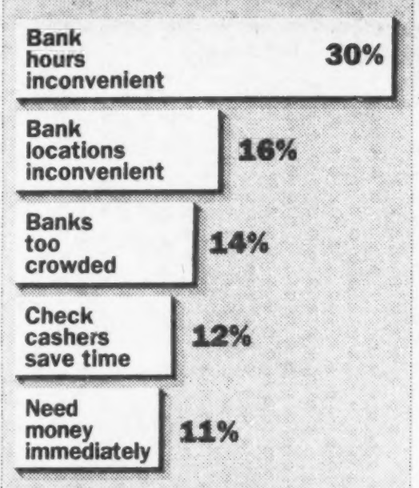
Why Bank Customers Use Check Cashers


Bank hours inconvenient 30%
Bank locations inconvenient 16%
Banks too crowded 14%
Check cashers save time 12%
Need money immediately 11%

Base: 337 check-cashing customers who have financial institution accounts
Source: Consumer Bankers Association

Bankers' Survey Disputes Need For Lifeline Law

By YVETTE D. KANTROW

NEW YORK — The Consumer Bankers Association Monday became the latest banking trade group to produce research challenging the need for a law requiring banks to cash checks for people who lack bank accounts.

As support grows on Capitol Hill for legislation that would require banks to provide low-cost services to the poor, the Consumer Bankers Association released a survey concluding that such a law would not necessarily benefit low-income people.

See **CONSUMER** *page* **13**

Riegle Opposes Efforts To Amend S&L Bailout

By ROBERT M. GARSSON

WASHINGTON — Senate Banking Committee Chairman Donald W. Riegle said Monday that he opposes efforts to amend the 1989 thrift-bailout law this year, harming prospects for such legislation.

Speaking to a group of credit union executives, Mr. Riegle also said he sees "no enthusiasm among my colleagues" in the Senate for legislation ending that industry's tax advantages.

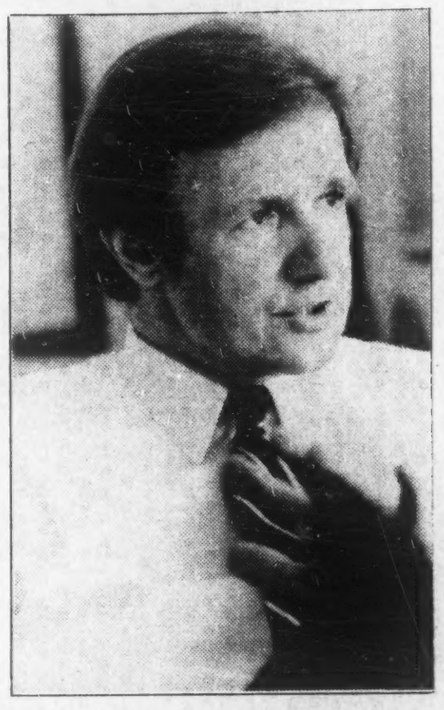
Referring to the bailout, the Michigan Democrat said: "Some people have asked, 'Should we go back and revisit the thrift legislation?'

"The answer to that is 'no.' We did a good job on that bill. It is necessary to give it time to work. I have no intention of opening it back up."

Avoiding Entanglement

Mr. Riegle is thought to be especially eager to avoid becoming embroiled in another messy thrift bill now – as the Senate Ethics Committee investigates whether he improperly intervened with federal regulators on behalf of Charles H. Keating Jr.'s failing Lincoln Savings and Loan Association.

House Banking Committee Chairman Henry B. Gonzalez, D-Tex., has said a modest S&L bill might be appropriate this



Donald W. Riegle
Senate Banking Chairman

year, and a number of key lawmakers are preparing legislation that would, among other things, dismantle the thrift regulatory structure.

But Mr. Riegle is in a commanding position to block a new S&L bill if he chooses, especially if it is not linked to a "must" piece of legislation, as was the case with last year's bailout. Moreover, Mr. Riegle's sentiment appears to be widely shared in the Senate.

Reacting to Mr. Riegle's com-

See **RIEGLE** *page* **11**

Mounting Loan-Loss Provisions Weaken Regional Bank Profits

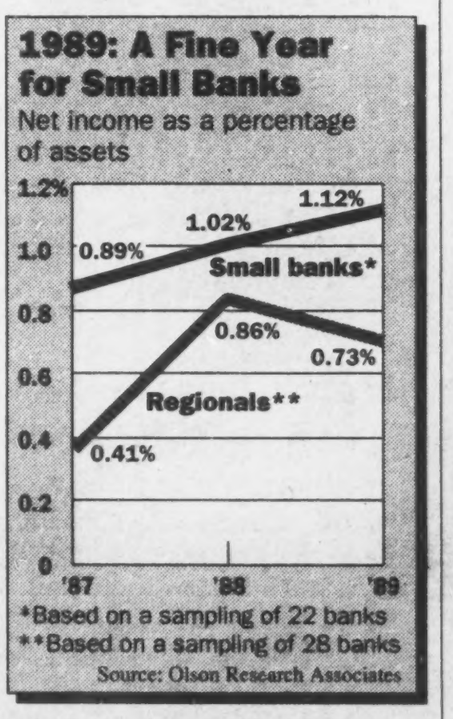
By SANFORD ROSE

After rebounding sharply in 1988, the earnings of regional banks worsened appreciably in 1989. By contrast, small community banks registered a significant earnings improvement last year, continuing a positive trend that began in 1987.

These are the major findings of the annual survey of banks undertaken by Olson Research Associates of Greenbelt, Md. The survey encompasses 100 banks – 22 small, 50 midsize, and 28 with over $1 billion in assets. These institutions represent a cross-section of the industry and account for $131 billion in assets, or approximately 4% of all assets held by U.S. commercial banks.

While the small banks did well in 1989, the midsize institutions faltered slightly. But the worst troubles were encountered by those 28 regionals. Their 1989 return on assets fell 13 basis points, from 86 to 73 basis points. And their return on equity nosedived, from 14.37% to 11.83% – the second-worst declension in a decade.

1989: A Fine Year for Small Banks
Net income as a percentage of assets



*Based on a sampling of 22 banks
**Based on a sampling of 28 banks
Source: Olson Research Associates

Since the regionals dominate the Olson sample, holding $112.5 billion of the $131 billion in assets, the 1989 returns of the entire group of 100 banks also proved disappointing. ROA fell from 87 to 75 basis points. And ROE dropped from 13.97% to 11.74%.

The 28 regionals in the Olson

See **MOUNTING** *page* **11**

Banc One Gives Video Banking Another Whirl

By KAREN GULLO

NEW YORK — Banc One Corp. is giving video banking another shot.

The Columbus, Ohio, holding company, which failed at three earlier attempts to enter the video banking market, said last week that it will offer home banking services over the Prodigy network.

The move by one of the nation's most innovative retail banking organizations is likely to give a boost to Prodigy Services Co., a partnership of International Business Machines Corp. and Sears, Roebuck and Co. Prodigy claims that 200,000 computer owners nationwide subscribe to its information network, but results in the banking area have been mixed. Just last week, Sovran Financial Corp., Norfolk, Va., said that as of March 1 it would discontinue its Prodigy banking service in the Washington area, where it had 1,000 users.

See **BANC ONE** *page* **13**

PEOPLE *in the news*

Texas Banker Back in Fray And Upbeat About the '90s

By STEVE KLINKERMAN

DALLAS — After a decade of crisis, veteran Texas banker Robert H. Stewart 3d is hoping for a decade of fun.

The former chairman of InterFirst Corp. was named vice chairman Monday of Team Bank, Fort Worth, the $5 billion bank formed by the merger of Texas American Bancshares and Deposit Guaranty Bank, Dallas.

Robert H. Stewart 3d

The Team Bank post is a homecoming for Mr. Stewart, who is 64. He will be returning not only to the big leagues of Texas banking but also to the side of Ronald Steinhart, the former InterFirst president who is chairman and chief executive of Team Bank.

"I've had a great friendship with Ron," said Mr. Stewart, who recently resigned from LaSalle Energy Corp. after a two-year stint in which the Texas-based company's major assets were sold. The duo's roles will be reversed at Team Bank, however, where Mr. Stewart for the first time will be working for Mr. Steinhart.

Mr. Stewart's two years at LaSalle capped a tumultous decade in Texas.

After relinquishing the chairmanship of InterFirst to Elvis Mason in 1980, Mr. Stewart was thrust back into the post in 1984 after Mr. Mason's loans to oilfield service companies virtually crippled the company.

Mr. Stewart led InterFirst for four years, ultimately guiding it into a June 1987 merger with cross-town rival RepublicBank Corp. He resigned as chairman of First RepublicBank Corp., the merged entity, months before heavy losses and a deposit run forced it to ask for federal aid in early 1988.

Despite First Republic's troubles, Mr. Stewart didn't lose his appetite for banking. "Bob has put his life into the banking business," said Gene Bishop, a longtime friend and tennis partner who is chairman and chief executive of MCorp, Dallas. "He wanted to stay involved in the industry."

With Monday's announcement, Mr. Stewart's wish has been fulfilled. Drawing on his considerable Texas connections, he will seek customers for Team Bank. And he hopes to put an era of trouble to rest. "I'm just glad to be back," he said. □

NEWS *briefs*

Bank of New England Sells Credit Cards to Citicorp

NEW YORK — Bank of New England Corp. said Monday it completed the previously announced sale of its credit card business to Citicorp for $828 million.

The sale will result in a gain of about $176 million for the troubled Boston-based holding company. The premium of 27% for of Bank of New England's $652 million in credit card receivables is one of the highest ever paid in such a sale.

The card portfolio sale was part of program to divest $6 billion in assets, as outlined by Bank of New England last month. The company last week also announced the sale of its vehicle leasing subsidiary to a unit of GE Capital Corp. for an undisclosed price.

"Indications are that we can expect to report further progress in the coming weeks," said interim chairman H. Ridgely Bullock in a prepared statement.

— Jed Horowitz

BancTexas Fights Order To Capitalize Two Units

DALLAS — BancTexas Group Inc. said it applied to the U.S. District Court in Texas for an injunction to limit a temporary order by the Federal Reserve Bank, pending a formal hearing.

The Federal Reserve Bank had scheduled a hearing for March 20 to decide whether BancTexas should use all resources to inject capital into two banking subsidiaries. It also ordered BancTexas to infuse capital into those banks immediately.

The banking company said the Fed order is not upheld by legislation, adding that it believes the temporary action is premature and should be enjoined pending a hearing.

— Reuters

Gonzalez Urges President To Replace Wall Quickly

WASHINGTON — House Banking Committee Chairman Henry B. Gonzalez, complaining that M. Danny Wall continues to sit as the nation's top thrift regulator two months after his resignation, asked President Bush to name a successor immediately.

"Not only does Mr. Wall continue to direct the activities of OTS, but he sits as a voting member of the board of the Federal Deposit Insurance Corp.," Mr. Gonzalez said in his Feb. 2 letter.

He added that Mr. Wall's presence suggests an atmosphere of "business as usual" to "employees on the front line of regulation." □

Top Lending Officers Resign at First Bank

By NANINE ALEXANDER

NEW YORK — Less than a week after being named chairman and chief executive of First Bank System Inc., John G. Grundhofer announced Monday that three senior lending officers had resigned in a continuing restructuring designed to improve credit quality.

Though a spokesman for Minneapolis-based First Bank denied that the three were fired, analysts speculated that Mr. Grundhofer's hiring prompted their departure.

'It Makes Sense'

"If you look at his focus on credit quality," said Ben Crabtree, analyst at Dain Bosworth Inc., referring to Mr. Grundhofer, "it makes sense that he would bring in people he's more comfortable with."

The executives who resigned, effective Monday, are Richard W. Schoenke, chief credit and administrative officer; Jay B. Walters, president, commercial and investment banking; and Richard L. Shepley, executive vice president, credit policy.

Faced with mounting credit problems, First Bank last fall announced a major restructuring that included a $2 billion reduction in assets and firing nearly 20% of the staff.

Restructuring's Overseer

Mr. Grundhofer said that Darrell G. Knudson, vice chairman, will oversee the restructuring of First Bank's commercial and investment banking operations. The revamping is to include revisions of loan underwriting standards, continued cuts in commercial assets, evaluation of lender performance standards and compensation programs, and a review of internal lending limits.

Some analysts speculated that Mr. Grundhofer, who took office Wednesday, would hire executives from bottom-line-oriented Wells Fargo & Co., where he had been vice chairman, to help cut costs at First Bank. □

House Panel Asks CIA to Comment On Reported Link to S&L Failures

By BILL ATKINSON

WASHINGTON — Concerned about reports that the Central Intelligence Agency played a role in the failure of 22 savings and loans, Rep. Frank Annunzio, D-Ill., has requested to meet with CIA Director William H. Webster.

In a letter sent to Mr. Webster on Monday, Mr. Annunzio said that allegations in a *Houston Post* story are "serious and troubling." As chairman of the House Banking subcommittee on financial institutions, Mr. Annunzio requested that Mr. Webster appear before a closed meeting of the panel as soon as possible.

According to the *Post's* story, which was published Sunday, the CIA may have received fraudulent loans that contributed to the failure of 22 thrifts.

The story charged that the CIA used the loan proceeds to finance such covert operations as aid to the Nicaraguan contras, gun running, drug smuggling, and money laundering.

The newspaper also said it found links between the CIA and organized crime in the thrift fraud.

See **PAPER** *page* **14**

Clausen Says He Will Retire

By SAM ZUCKERMAN

SAN FRANCISCO — A.W. Clausen, 66, announced on Monday that he will retire as chairman and chief executive officer of BankAmerica Corp. at the bank company's annual meeting on May 24. He will be succeeded by 59-year-old vice chairman Richard M. Rosenberg, head of Bank of America's California banking group.

Both Mr. Clausen's retirement after more than three years in a second term as BankAmerica chief and Mr. Rosenberg's promotion to the company's top job had been widely expected. Following retirement, Mr. Clausen will remain on the boards of BankAmerica and its Bank of America subsidiary, serving as head of the executive committees of both panels.

Corrections

A Feb. 2 article ("Bankers Trust Continues to Clean House," page 11) incorrectly described a unit of BT Delaware closed by Bankers Trust New York Corp., its parent. The business, a domestic check-processing unit, employed 15 people. The company also denied speculation that it will reduce the size of its domestic cash management or private banking units.

■

A Jan. 25 article ("Las Vegas Bank: 16 ATM Network Links," page 6) incorrectly described how Valley Bank of Nevada established links with three midwestern automated teller machine networks – Magic Line, Shazam, and Tyme. The links were made through the San Diego-based Star System network. The bank originally stated – incorrectly – that it had agreed directly with the networks. □

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COMMENT/ *By Paul Nadler*

First of Maryland Keeps Its Irish Owners Smiling

The awards meeting of the First National Bank of Maryland offered several insights that should be of interest to other banks.

There was a predominance of women among the 1,200 award winners at the function – which was held at a posh Baltimore hotel, with all the trimmings, to make them feel special.

I was reminded that for the first decade or so that I taught at the Stonier Banking School of the American Bankers Association, not one of the 400 or so students was female. They were not considered important enough to attend this top officer training school. ("We never waste a man when a woman can do a job," was the way one Philadelphia banker responded in my presence as late as 1970 to a question about discrimination against women.)

Irish Owners Don't Meddle

Although First of Maryland is wholly owned by Allied Irish Bank, this fact has meant virtually nothing in the operation of the bank and in the thoughts of the attendees I talked to.

Out of 4,000 employees, there are only four from Ireland – two top officers and two foreign exchange people. But the only recognition given to chairman Jerry Casey, the top Dublin representative in the bank, was a 50th birthday present of a bunch of carrots (since Bugs Bunny also will be 50 this year).

The rest of the meeting was conducted by Joseph Cole Jr., chief executive officer. He is a Maryland native who has been with First of Maryland for more than a quarter of a century. In fact, the people at the meeting felt that being fully owned by the Irish was great, because it alleviated the fear of unfriendly raids. The shoe had already dropped, and it didn't hurt at all.

Ambassador and Auditor

To be sure, Dublin likes growth in profits. But as long as First of Maryland provides that, Mr. Casey feels his role is to be "an ambassador and an auditor, wrapped into one." He is quick to stress that Mr. Cole and his staff of five executive vice presidents – all of whom also have about 25 years with the bank – run the institution.

But what was more interesting than the bank's structure were the questions raised when I ran a morning seminar for 50 people ranging from trainees to top line people. The "hot button" that most interested them was the suggestion that each teller make two calls every evening to thank people who had come into the bank that day.

Although the attendees felt that banks have very little contact with customers and that these so-called warm calls offer a lot of value over cold calls that often bother people, they feared the interruption of people's dinner and evenings might hurt the bank's image. We agreed, finally, that the opening sentence of any such warm call should be "Is this a good time, or should I call later?"

Are Mea Culpas Necessary?

Equally interesting was the question "If our bank makes a mistake, should we admit it?"

This got me screaming a violent "Yes!" In banking, while customers accept occasional errors, the point most of them make in surveys is that they hate it most when a lot of effort is required to get the errors corrected. This applies to small customers as well as corporate treasurers with giant balances.

The main point that came out is that when an organization or individual makes an error and admits it and tries to correct it, frequently in the end there is a closer tie between the organization and the customer than if the error not been made in the first place.

Compare AT&T with Audi. When AT&T had a computer glitch last month, it apologized. The company said it was embarrassed, would make amends through lower rates on Feb. 14, and would strive to be better.

In our discussion, executive vice president Joe Peters hit the nail on the head when he said the one answer customers will not stand for when an error has been committed is, "The computer broke." "Nonsense," he said. "We are responsible for the computer too."

When there were reports that its cars suddenly lurched forward, Audi took the other approach and said, "Americans just don't know how to drive" – a statement that cost it a giant share of its market in the United States.

Federal Express Dropped Ball

Federal Express lost the package with Westinghouse Scholar applications from Stuyvesant High School in New York and students missed the deadline after years of work. The company had an opportunity to say it would pay for all the scholarships won by applications in the package that got lost, if Westinghouse would only process them like the others despite their late arrival. Such a step would have turned an operational snafu into a public relations coup at minor cost.

So there we were in Baltimore, honoring 1,200 people, printing the names of about 700 who had perfect attendance records, and talking about errors, nonobtrusive calls, and most important, quality of service. Maybe that is why the bank does so well and why the Irish owners are so happy leaving them alone. □

Mr. Nadler is professor of finance at Rutgers University's Graduate School of Management.

CRIME BLOTTER/ *By Tom Leander*

Judge Orders Felon To Get Rich Quick

In what the Federal Deposit Insurance Corp. is calling the largest restitution award ever in a loan-fraud case, a federal judge has ordered Jerry D. Smith to repay $13 million he wrongfully took from Queen City Savings and Loan Association, Seattle.

And the judge expressed confidence in Mr. Smith's ability to raise the money. Once Mr. Smith finishes serving 10 years in prison for loan fraud, Judge John C. Coughenour has given him only five years him to repay the $13 million.

The judge's order acknowledges that Mr. Smith "may not currently possess significant assets," but notes, "he has demonstrated the ability to accumulate assets in the amount of this restitution order within five years from his release from custody." Mr. Smith was sentenced without parole.

Mr. Smith was not an officer or director of the Seattle thrift, but owned a substantial portion of Queen City stock, according to Jack D. Smith, deputy general counsel at the FDIC. Jerry Smith was convicted of arranging $16 million in fraudulent loans in Texas with coconspirators at Queen City in 1988.

Losses on these loans led to the collapse of Queen City and its seizure by regulators. The former Federal Savings and Loan Insurance Corp. sold the thrift's assets to Gibraltar Savings and Loan Association, another Seattle thrift seized last year by regulators.

The restitution ruling allows the FDIC to search for assets that Mr. Smith may have hidden.

"It is our belief that Jerry Smith has funds that are secreted and that would amount to substantial recovery," said the deputy general counsel.

* * *

Background Checks Keep Agency Busy

International private banks are stepping up efforts to investigate financial backgrounds of potential clients, according to the head of one of the largest private-detective companies in the United States.

James Mintz, president of the Investigative Group Inc., reports a flood of requests for background checks that has grown steadily since late last year.

Mr. Mintz attributes the rise to an increased determination to suppress money laundering and drug trafficking in this country. He also cited a letter issued by the Bank of England in November, warning banks that they must install adequate controls to prevent money laundering.

The Investigative Group has offices in London and in New York and four other U.S. cities.

* * *

Bank Heist Suspect Returned to Scene

Police in Brooklyn, N.Y., nabbed a panhandler who allegedly held up First Federal Savings Bank, then resumed his customary curbside begging post outside the bank.

Peter Nuzzi, 30, is charged with walking into the thrift on Flatbush Avenue, leaping over a teller counter, and scooping an undisclosed amount of cash from a open drawer. Mr. Nuzzi claimed that he was armed, according to New York City police officer Joseph Gallagher.

Two days later, several bank employees observed Mr. Nuzzi return to his customary panhandling spot in front of the thrift. They identified him to police, who charged him with bank robbery and possession of a deadly weapon.

* * *

Connecticut National Indictment Dropped

A money-laundering indictment against Connecticut National Bank has been dismissed because prosecutors waited too long to bring the charges, a federal judge ruled.

Connecticut National, a unit of Boston-based Shawmut National Corp., was indicted last November of failing to file currency transaction reports on deposits made by two brothers from Milford, Conn., who jointly own a restaurant chain.

Judge Warren Eginton, in Bridgeport, Conn., tossed out the indictment when prosecutor John Durham conceded that the charges were brought after the five-year statute of limitations on money-laundering prosecutions had run out.

The prosecutor said he plans to seek another indictment from a federal grand jury on similar, but more recent, money-laundering charges within the five-year limit. □

Reader Forum

The *American Banker* welcomes points of view on issues of interest and importance to the banking industry.

Please direct them to Jeffrey Kutler, assistant managing editor, American Banker, One State Street Plaza, New York, N.Y. 10004, and please include a daytime telephone number. Letters may be edited for space for a Letters to the Editor column or published separately as commentary.

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Mounting Loss Provisions Sap Regional Profits

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sample were saddled with a variety of problems last year. On average, interest rates rose during 1989, increasing both the asset yield and the cost of funds. But for these institutions, the cost of funds rose by more than did the asset yield – 106 basis points versus 94 basis points. So the banking spread dropped.

The concomitant fall in the banking margin – interest revenue minus interest expense as a percent of earning assets – was to some extent blunted by the increased use of equity funds, which of course bear no explicit interest cost. Nevertheless, the regional-bank margin still fell slightly, exerting downward pressure on the ROA. And because these banks were using more equity money and were therefore deleveraging, the lower ROA translated into an even sharper drop in the ROE.

Additionally, the regionals were not able to make progress in reducing the overhead burden, defined as noninterest expenses minus noninterest revenue as a percent of earning assets. Indeed, the net overhead ratio actually inched up last year, reflecting both the rise in expenses and an apparent loss of momentum in generating noninterest revenue.

Overstated Earnings

But by far the most significant factor in the 1989 earnings equation was the behavior of the loan-loss provision. A good deal of the 1988 recovery in earnings at regional banks was attributable to a sharp reduction in the loan-loss provision. In 1988, these banks virtually halved the provision, dropping it from 1.61% to only 0.82% of loans.

However, in their zeal to show higher profits in 1988 after a dismal 1987 showing, the regionals apparently went too far. They overcut the provision, in effect overstating 1988 earnings at the expense of profits in future years.

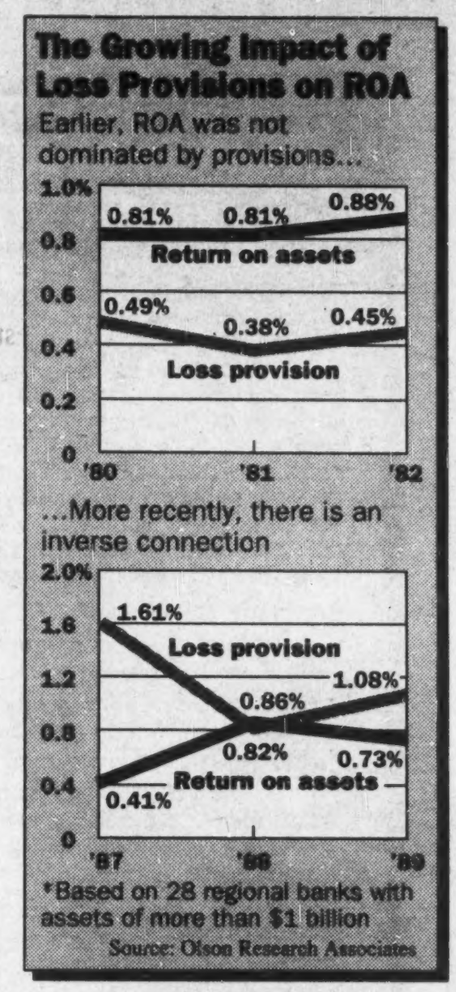
In 1989, these banks had to reverse themselves and once again fatten the loss provision. Had they not done so, the rapid growth in 1989 loans would have caused an unacceptably large decline in the ratio of loss reserves to loans.

Last year, the regionals allocated 6.5 cents of every dollar of income to the provision, compared to only 5.3 cents in 1988. In absolute dollars, they earmarked around $260 million more to the provision than in 1988. If the regionals had been able to forgo this increase, their aftertax ROA would have gone up by around 3 basis points in 1989 instead of falling by 13 basis points.

Counterintuitive Finding

For the 22 banks in the Olson sample with assets of under $100 million, last year's results were quite a bit more encouraging. ROA rose 10 basis points, to 1.12%, while ROE, despite a modest deleveraging, moved from 11.22% to 12.19%.

These community institutions experienced some compression in their spreads, but less than at the bigger banks – a result that is somewhat counterintuitive since community banks are supposed to be more liability sensitive than bigger banks and therefore more prone to be hurt by rising interest rates.



Since the fall in the spread was comparatively modest, given that these banks also employed relatively more equity money to fund their assets in 1989 than in 1988, their margin rose a tad, slightly buoying the ROA. Unlike the regionals, the community institutions were able to pare the net overhead ratio, which fell from 2.61% to 2.55% of earning assets. And also unlike the regionals, the tiny institutions found it possible to continue reducing the loan-loss provision, which dropped from 3.4 cents per dollar of income to 2.6 cents.

The most significant factor in the 1989 earnings equation was the behavior of the loan-loss provision.

Muted Growth

Whether the reduction in the provision is sustainable is, however, subject to question. The community institutions were able to reduce the provision largely because their loan growth in 1989 was much less rapid than at regional institutions. So while the decline in the provision lowered the ratio of reserves to loans, it did not lower it by an unacceptable amount. On the other hand, loan chargeoffs at community banks were rising in 1989, as was the nonperformer ratio.

Unless these adverse credit trends are quickly reversed, the small banks may soon be required to beef up the provision, even if loan growth remains comparatively muted.

As of now, however, the community banks seem in better shape than they have been for a long time. At 1.12%, their ROA is higher than it has been since 1982 and higher than that recorded by the regionals in any year in the last decade.

Decade of Decline

Since 1989 represents the end of a decade, it is useful to compare the current condition of banks with that which prevailed at the start of the '80s. The average bank in the Olson sample of small and regional institutions is now much worse off than it was in 1980. Both its ROE and ROA have dropped.

But the decline has not been monotonic. Bank returns generally improved in the early '80s before faltering in 1983, as the effects of the last recession began to be felt. Returns perked up in the mid-'80s. But by the late '80s, profitability once again turned down, this time undoubtedly because of the effects of the disinflation that followed the recession and began to devastate the fortunes of real estate, energy, and agricultural borrowers.

Significantly, the impact of the decline in the relative prices of land and oil was much more deleterious to banks than that of recession itself. Bank fortunes reached a nadir in 1987, when the loss provision had to be raised by over 50% and, in consequence, the bank ROA tumbled from 87 to 47 basis points.

Banks recovered sharply in 1988, but, as noted, this recovery was in some sense illusory since it was achieved by a massive decline in the loan-loss provision that has thus far proved unsustainable. Banks might have been better off if they had reduced the provision more gradually in 1988 than was in fact the case.

Higher Spread, Lower Margin

The average bank now earns a much higher spread than it made in 1980. This is largely because of the shift in asset allocation from low-yielding securities to much higher-yielding loans. The ratio of loans to assets has increased from 66.5% at the beginning of the decade to 73% currently. While serving to bolster the spread, the shift from securities to loans has had the unfortunate side effect of promoting a secularly higher level of chargeoffs and a significant rise in the ratio of nonperforming assets.

Moreover, despite the rise in banking spread, the banking margin has fallen inexorably, from 5.03% in 1980 to around 4.40% at present. This slippage is, of course, almost entirely due to the erosion in noninterest-bearing demand deposits.

Banks have striven to offset the effects of reduced margins in part by paring noninterest expenses and also by reaching for higher levels of noninterest revenue. In 1980, the net overhead burden amounted to 2.72% of earning assets. It has since fallen to 2.22%. However, most of the progress in reducing net overhead was achieved in the early to mid-'80s. Since 1987, the overhead burden has remained virtually constant.

To be sure, banks are today better capitalized and much more heavily reserved than they were in 1980. Given the higher ratio of loans to assets and the increase in borrowed funds, they are also much less liquid. And should the economy falter, the fact that banks are so heavily loaned up may well lead to a further explosion in chargeoff ratios from levels that are still more than 50% higher than they were at the beginning of the '80s. □

Riegle Opposes Efforts to Amend S&L-Bailout Bill

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ments, Rep. Jim Leach, R-Iowa, conceded that new S&L legislation is unlikely to pass unless it can be attached to a needed money bill, such as legislation authorizing working capital for the Resolution Trust Corp. "Sen. Riegle's statement is pretty significant," he said.

Mr. Leach said he plans to offer a bill disbanding the Office of Thrift Supervision and moving its regulatory functions into the three federal bank supervisory agencies.

Taxing Credit Unions

Mr. Riegle said that taxing credit unions could be counterproductive since it might encourage them to return a greater share of profits to members by paying higher interest on deposits and charging less for loans. He sits on the Senate Finance Committee, which has jurisdiction over tax matters.

He told the Credit Union National Association's annual governmental affairs conference that Congress is not likely to consider merging the credit union industry's share insurance fund into the bank and thrift funds.

"It's not even being seriously considered on Capitol Hill," he said, "so it's not even a live issue, much less a threat." □

Hearings to Resume on Lincoln S&L

WASHINGTON — House Banking Committee chairman Henry B. Gonzalez plans to resume hearings this month on the failure of Lincoln Savings and Loan Association, Irvine, Calif.

Although the committee has not made a formal announcement, staff sources said the public inquiry into the American Continental Corp. subsidiary will probably pick up again during the third week of the month.

Mr. Gonzalez plans to take a look at the role played by junk bond financing in the failure of the thrift, and he has subpoenaed junk bond king Michael Milken.

Mr. Gonzalez will probably also examine other failed thrifts, including Denver-based Silverado Banking, Savings and Loan Association, an institution notable in part because President Bush's son Neil sat on the board of directors.

The Office of Thrift Supervision has accused Neil Bush of a conflict of interest in voting on a loan to a business associate. He has refused to sign an agreement to settle the case. □

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